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Protected Cell Companies in Guernsey

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This briefing note describes the key features of a protected cell company ("PCC") and summarises the formation, structure and the liquidation procedures particular to this type of company.

A PCC consists of a core and one or more cells. The assets and liabilities of one cell are segregated and protected from those of the other cells. Similarly, the assets and liabilities of the core are segregated and protected from those of the cells.

For investment funds, the attraction of a PCC is the avoidance of any cross-class contagion if a class or portfolio within an umbrella fund becomes insolvent and if the creditors attempt to enforce judgments against assets within other classes.

Insurance companies have found the PCC structure attractive for use by rent-a-captives, transformers and a wide range of other alternative risk transfer solutions. There have also been a number of catastrophe bond issues and the securitisation of life business within individual cells of a PCC.

What are the key features of a PCC?

The principle is that where any liability arises that is attributable to a particular cell or to the core, the cellular assets attributable to that cell or the core assets attributable to the core, should be used in satisfaction of the liability. Thus, when considering a liability attributable to a cell, the core assets and the assets attributable to any cell other than the cell to which the relevant liability is attributable, are "protected assets".

Unless excluded in writing, it is an implied term of every transaction to which a PCC is party that no party shall make or attempt to make liable any "protected assets.

Who can be a PCC?

The following may be or become a PCC:

- an authorised or registered collective investment scheme under The Protection of Investors Law, 2020, as amended (the "POI Law");
- a company licensed to carry on controlled investment business within the meaning of the POI Law;
- a closed-ended investment company;
- a corporate licensee within the meaning of the Insurance Business (Bailiwick of Guernsey) Law, 2002, as amended (the "Insurance Law"); and
- a company administered by a person with a licence under the POI Law, the Insurance Law, the Banking Supervision (Bailiwick of Guernsey) Law, 2020 (as amended), the Regulation of Fiduciaries, Administration Business and Company Directors etc (Bailiwick of Guernsey) Law, 2020 (as amended) or the Insurance Managers and Insurance Intermediaries (Bailiwick of Guernsey) Law, 2002 (as amended).

Licensed Guernsey banks, insurance managers or intermediaries and licensed fiduciary companies cannot be or become PCCs.

Incorporation of a PCC

In order to incorporate a PCC it is necessary to obtain the prior written consent of the Guernsey Financial Services Commission ("GFSC"). This consent must be also obtained when converting:

- a non-cellular company into a PCC;
- a PCC into a non-cellular company; or
- a cell of a PCC into a non-cellular company

The letters "PCC" or "Protected Cell" must be included in the PCC's name. The Memorandum of Incorporation must state that the company is a PCC. Additionally, each cell must have its own distinct name and assets.

A PCC may issue shares attributable to the cell or the core. The proceeds of issue of shares attributable to a cell are comprised in the cellular assets attributable to that cell. Proceeds of issue from shares other than cell shares are comprised in the core assets.

Separation of assets

The directors of the PCC must keep cellular assets separate and separately identifiable from the core assets and also keep cellular assets attributable to each cell separate and separately identifiable from cellular assets attributable to other cells. Nonetheless, the assets of a PCC may be collectively invested, provided that they remain separately identifiable. The assets of a PCC may also be held by a nominee or underlying company, the capital of which forms cell or core assets (as the case may be).

Attributing liability and recourse against assets

Subject to the terms of any recourse agreement, the assets attributable to a cell must be used in satisfaction of any liability attributable to that cell. In the same way, the assets attributable to the core are liable in respect of liabilities attributable to the core.

A recourse agreement is a written agreement between a PCC and a creditor which provides that "protected assets" may be subject to a liability owed to a creditor. Prior to entering into a recourse agreement, each director of the PCC who authorised entry into the recourse agreement, must make a declaration that he believes on reasonable grounds that no creditor of the PCC will be unfairly prejudiced by the agreement. The declaration must also state that a resolution has been passed by the core members or the members of the relevant cell (as appropriate) approving the recourse agreement, unless the memorandum and articles of incorporation provide otherwise. A director who makes a declaration without grounds is guilty of an offence.

Liabilities of a PCC not otherwise attributable to any of its cells must be discharged from the PCC's core assets. If there is a dispute as to whether a right, liability or creditor is or is not attributable to a particular cell or as to the amount to which any liability is limited, the Court may, on the application of a PCC issue a declaration thereon.

Information obligation

A PCC must inform any person with whom it transacts that it is a PCC and identify or specify the cell in respect of which that person is transacting that the transaction is in respect of the core (as appropriate). If a PCC fails to provide the transacting party with this information then the directors become personally liable to the counterparty to the contract. Unless the directors were fraudulent, reckless, negligent or acted in bad faith, they have a right of indemnity for that liability out of the core assets of the company. Only the Court can relieve the directors from this liability for grounds set out further in the Law.

Transferring cellular assets to third parties

No transfer of the cellular assets of a PCC may be made without the approval of the Court. Provided that a PCC may lawfully make payments or transfers from cellular assets (1) to a person entitled to have recourse to those assets and (2) made in the ordinary course of the Company's business.

The Court will only approve a transfer of cellular assets if it is satisfied that the creditors of the cell concerned have consented to the transfer or would not be unfairly prejudiced by the transfer. The GFSC has a right to make representations to the Court in respect of the transfer. A transfer can be approved by the Court even though the PCC is being wound up or it or any of its cells is subject to an order for receivership or administration.

Arrangements between cells affecting cellular assets

A PCC may in the ordinary course of its business, or the business attributable to any of its cells, make an arrangement where it deals, transfers, disposes or attributes cellular or core assets between any of its cells or between the PCC and any of its cells. If necessary, the PCC must adjust its accounting records and those of the affected cells to reflect the arrangement. The PCC itself, its liquidators or administrators, or the receiver or administrator of any cell may apply to the Court to make an order in respect of the execution, administration or enforcement of an arrangement.

Conversions

There are a range of conversions possible with PCCs. The process to effect a conversion is the same regardless of the particular transaction being considered: the consent of the GFSC is always required as well as a special resolution of the shareholders of the entity (or cell) which wishes to convert. The conversions which are possible are:

- a non-cellular company may convert into a PCC;
- a PCC may convert into an incorporated cell company;
- a PCC may convert into a non-cellular company; and
- a cell of a PCC may convert into a non-cellular company.

Liquidation of a PCC

The general rule that on liquidation of all of a company's assets must be applied in satisfaction of the company's debts and liabilities pari passu is modified in relation to PCCs. The liquidator may apply a cell's assets only to those creditors entitled to have recourse to them.

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Administration of a PCC

An administration order may be made in respect of a PCC or any one or more of its cells if the Court is satisfied that the PCC (or cell) does not satisfy or is likely to become unable to satisfy, the solvency test set out in the Law, and if the Court considers that the making of an administration order may achieve one or more of the following:

- the survival of the PCC or cell (as the case may be) and the whole or any part of its undertaking, as a going concern; or
- a more advantageous realisation of the PCC's or cell's (as the case may be) assets than would be effected on a winding up.

An administration order creates a moratorium on winding up of or commencement of proceedings against the PCC (without the leave of the Court) during the period between the application and the making of the actual administration order. The moratorium does not affect rights of set-off and security interests.

An administrator is empowered to do all such things as may be necessary or expedient for the management of the affairs, business and property of the PCC or cell. Upon his appointment, the administrator must take into his custody or control all the property to which the PCC or cell appears entitled. The administrator must also manage the affairs, business and property of the PCC or cell in accordance with any directions given by the Court. The administrator can remove and appoint directors. Neither an application for administration, nor the consequent order for administration, results in a statutory cessation of the powers and responsibilities of the directors. However, any functions conferred on the PCC or its officers constitutionally or by Law which could be performed in a way which interferes with the administrator's functions, may not be performed unless the administrator gives his consent.

An administration order in respect of a cell of a PCC may not be made if a liquidator has been appointed to act in respect of the PCC, if an application has been made for the winding up of the PCC or if the PCC has passed a resolution for voluntary winding up. An administration order ceases to have effect when a liquidator is appointed. A resolution for the voluntary winding up of a PCC or any cell which is subject to an administration order, can only be made with the approval of the Court.

Receivership of cells in a PCC

A receivership order may be made by the Court in respect of one or more cells of a PCC where:

- taking account of any assets subject to a recourse agreement, the cellular assets attributable to a particular cell are, or are likely to be, insufficient to discharge the creditor's claims in respect of that cell;
- the making of an administration order in respect of that cell would not be appropriate, and
- the making of an order would achieve the orderly winding up of the business of that cell and the distribution of the cellular assets to those who have recourse against them.

During the continuance of a receivership order, the powers and responsibilities of the directors cease. There is a court sanctioned moratorium during the operation of the receivership order against resolutions for the winding up of the company and on the commencement or continuance of proceedings against the relevant cell of the PCC (save with the leave of the Court). The moratorium does not affect rights of set-off and security interests.

Subject to rules on preferential payments, any subordination agreements and any setoff agreements, the PCC's cellular assets which are the subject of a receivership order must be realised and applied pari passu. Any surplus must be distributed to the cell shareholders or persons entitled thereto. If there are no such persons, it must be distributed among the holders of the core assets in accordance with their respective rights and interests.

Tax

The Guernsey tax treatment of a PCC is intended to reflect that the PCC is a single legal entity but at the same time protect investors in and creditors of one particular cell from the tax liability attributable to the profits of other cells. If eligible the PCC as a whole may elect for tax exempt status and the fee payable is not dependent on the number of cells comprised within the company. A single tax assessment will be raised on the PCC. However, the liability will be apportioned between the different cells and the core according to their entitlement to profits.

Foreign recognition

Since their introduction in Guernsey in 1997, a large number of jurisdictions have introduced the same concept – including notably more than 18 US states and the UK. This suggests a growing acceptance of the segregation of assets and liabilities created therein.

As a matter of comity, a foreign court ought to apply Guernsey law in determining questions concerning the segregation of the assets and liabilities of a PCC. We are unaware of any case in which the mechanism by which assets are segregated through a PCC has been challenged by a foreign court.

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